No. 14084

United States
COURT OF APPEALS
for the Ninth Circuit

OREGON-WASHINGTON PLYWOOD COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S BRIEF

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INDEX

Page

Introductory 1

Pleadings 1

Action of the Tax Court 2

Jurisdiction:
- The Tax Court 2
- This Court 3

Statement of the Case 4

Errors of the Tax Court Relied Upon 11

Statutes Involved 13

U. S. Conferring Jurisdiction:
- Sections 272, 1141 and 1142, Revenue Code, U.S.C.A. Tit. 26 ..... 2, 3

Defining borrowed capital:
- Sec. 719, I.R.C., U.S.C.A. Title 26 ..... 13, 14
- Sec. 439, I.R.C., U.S.C.A. Tit. 26 (1952 Sup.) 14
- Regulation 112, Sec. 35.719-1 13

Oregon Statutes:
- Sections 8-211, 9-501, 9-505, 68-101, O.C.L.A. 23

Rules of this Court, 10, 29 3

Argument:
- Summary 14
- Extended 15
- Nature of debt. Evidence of and security for same. 16
- The purchase contract a mortgage under Oregon laws. 16, 23-29
- The note an unconditional promise to pay. 17, 30-34
- The note an independent covenant to pay. 19, 34-35
- Obligation of petitioner unilateral. 19
- Optional right of vendors does not make petitioner's obligation conditional. 20
- Court decisions relied on by Tax Court 21

TABLE OF COURT DECISIONS

Page

Allen, Emma, v. Estate of Henry P. Allen, 217 Ill. Ap. 260 33

Backas, John, Estate of, 122 Neb. 531, 240 N.W. 596 34

Bank of Cal. vs. Bishop, 137 Ore. 34, 300 Pac. 1023 35

Benton v. Benton, 78 Kan. 366, 97 Pac. 378 33

Branch v. Lambert, 103 Ore. 423, 205 Pac. 995 31

Brewster Shirt Cpn. v. Commissioner, 159 Fed. 2d 719 24

Burkhart v. Howard, 14 Ore. 39 26

Collins v. Creason, 55 Ore. 524, 106 Pac. 445 25

Crooker v. Holmes, 65 Me. 195, 20 Am. R. 687 ..... 33, 34

Davis v. Wilson, 55 Ore. 403, 106 Pac. 795 26

Denning, Estate of, 112 Ore. 621, 229 Pac. 912 28

DeWolfe v. French, 51 Me. 420 34

Dickson v. Back, 32 Ore. 217, 51 Pac. 727 24

Erie R. Co. v. Tompkins, 82 L. Ed. 1194, 304 U.S. 78 15

Flannagan v. Great Cent. Land Co., 45 Ore. 335, 77 Pac. 485 ..... 25, 28

Grider v. Turnbow, 162 Ore. 622, 94 Pac. 2d 285 ..... 25, 28

Harrison v. Beal, 111 Ore. 563, 222 Pac. 728 32

Hicks v. Shouse, 17 B. Monroe 483 (Ky.) 34

Hughes v. McEwen, 112 Miss. 351, 73 So. 59 34

Jones v. Eisler, 3 Kan. 128 33

Loud v. Pomona Land & W. Co., 153 U.S. 564, 38 L. Ed. 822 35

McCracken v. Bay City Land Co., 93 Ore. 461, 183 Pac. 9 20

Marx v. La Rocque, 27 Ore. 45, 39 Pac. 401 23

TABLE OF COURT DECISIONS (Cont.)

Page

Naftzer v. Buser, 106 Kan. 115, 186 Pac. 997 32

Noland v. Bull, 24 Ore. 479, 33 Pac. 983 31

Nunez v. Dautel, 19 Wal. 560 ..... 31, 34

Oregon and Western Colz. Co. v. Strange, 123 Ore. 377, 260 Pac. 1002 35

Page v. Cook, 164 Mass. 116, 41 N.E. 115 34

Randall v. Johnson, 59 Miss. 317 34

Sears v. Wright, 24 Me. 278 34

Schleef v. Purdy et al., 107 Ore. 71, 214 Pac. 137 24

Security Savings Co. v. Mackenzie, 33 Ore. 209, 52 Pac. 1046 27

Smithers v. Junker, 41 Fed. 101, 7 L.R.A. 264 34

Thorp v. Rutherford, 150 Ore. 163, 43 Pac. 2d 907 35

Ubsdell v. Cunningham, 22 Mo. 124 34

Walker v. Hewett, 109 Ore. 366, 220 Pac. 147 35

Wilcox v. Turner, 51 Ga. App. 523, 181 S.E. 95 33

Williston v. Perkins, 51 Cal. 554 33

Works v. Hershy, 35 Ia. 341 33

TEXTS

Am. Jur., Vol. 8, page 26, par. 278 19

Am. Jur., Vol. 8, page 27, par. 281 30

C.J.S., Vol. 10, page 740, par. 245 30

No. 14084

United States
COURT OF APPEALS
for the Ninth Circuit

OREGON-WASHINGTON PLYWOOD COMPANY,
Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

PETITIONER'S BRIEF

Petition for review of decision of the Tax Court entered July 21, 1953, determining a deficiency in Petitioner's excess profits tax for the calendar year 1944, in the amount of $19,925.35. T. C. Docket No. 39553 (R. 24).

The letter R. and numbers immediately following refer to the printed transcript of record and page numbers.

PLEADINGS

Petition to Tax Court for redetermination of the Tax (R. 3).

Answer (R. 9).

ACTION OF THE TAX COURT

Findings of Fact (R. 12).

Opinion (R. 19).

Decision (R. 24).

JURISDICTION

Of the Tax Court:

Sec. 272, Internal Revenue Code, (U.S.C.A Tit. 26,) as amended Oct. 21, 1942, 56 Stat. 957 and Dec. 29, 1945, 56 Stat. 947, which provides if in the case of any taxpayer, the Commissioner determines there is a deficiency in respect to the tax imposed * * * the Commissioner is authorized to send notice of such deficiency to the taxpayer * * * Within ninety days after such notice is mailed * * * the taxpayer may file a petition with the Tax Court of the United States for a redetermination of the tax. The statute gives the Tax Court jurisdiction to redetermine the correct amount of the deficiency.

Deficiency in the amount of $19,925.35 determined by the Commissioner December 27, 1951. Petition for redetermination of the deficiency filed with the Tax Court March 19, 1952. Served March 20, 1952 (R. 3-8). Answer C.I.R. filed with the Tax Court May 5, 1952. Served May 12, 1952 (R. 9-11). Stipulation of facts filed with trial judge of the Tax Court October 17, 1952 and docketed (R. 25).

Of this Court:

Sec. 1141, as amended May 24, 1949, 63 Stat. 107, and Sec. 1142, Internal Revenue Code (U.S.C.A., Tit. 26).

Rules 10 and 29 this Court.

Petitioner is and was during all the years 1944-1945 an Oregon corporation. During those years it owned and operated a plywood plant at Tacoma, Washington; maintained an office at that location; was qualified to transact business in the State of Washington, and filed its income and excess profits tax return with and paid its income and excess profits tax to the Collector of Internal Revenue at Tacoma.

Sec. 1141, as amended, supra, confers upon this Court jurisdiction to review the decision of the Tax Court and to affirm, modify or reverse the same.

Section 1142 provides the decision of the Tax Court may be reviewed by this Court if a petition for such review is filed by the taxpayer within three months after the decision is rendered.

Rule 10 of this Court provides that in case of appeal or review the Clerk of the trial Court or Commission shall transmit to the Clerk of this Court the original files designated by the respective parties as the record of appeal or review. Rule 29 this Court provides that a party applying for review of a decision of the Tax Court shall file his petition with the Clerk of said Court * * * and shall serve a copy thereof, with notice thereof, upon the opposite party * * * That the Clerk of the Tax Court shall, within 40 days from the filing of the petition, transmit the record to the Clerk of this Court.

Decision of the Tax Court entered July 21, 1953 (R. 24).

Petition for review by this Court and assignment of error, with proof of service by mail, filed with Tax Court September 18, 1953 (R. 42).

Notice of filing petition for review with proof of service filed with Tax Court September 18, 1953 (Docket entry).

Notice to Ass't. Gen'l Counsel, Internal Revenue Service, that petition for review was filed September 18, 1953, mailed October 1, 1953.

Designation contents of record on review, agreed to by Ass't. Gen'l. Counsel, I.R.S. filed with Tax Court October 7, 1953 (Docket entry).

Statement of points, with proof of service, filed with Tax Court October 8, 1953 (Docket entry).

Record of proceedings in Tax Court, filed with Clerk of this Court October 19, 1953 (R. 47).

Points relied upon by petitioner filed with Clerk this Court October 22, 1953 (R. 48).

Designation of record to be printed mailed to Clerk of this Court and copy mailed to Acting Chief Counsel, Internal Revenue Service, Washington 25, D.C., October 20, 1953.

STATEMENT OF THE CASE

This Court is asked to review and reverse the decision of the Tax Court entered July 21, 1953, determining a deficiency in Petitioner's excess profits taxes for the year 1944 in the amount of $19,925.35, and to adjudge that there is no deficiency.

The point in issue is whether the indebtedness of the Petitioner hereinafter stated which was incurred for the purchase of timberland was "borrowed invested capital" within the meaning of Section 719(a)(1) of the Internal

Revenue Code in effect in 1944. It is stipulated that if said indebtedness was borrowed invested capital of the Petitioner within the meaning of said provision of the Revenue Code, there is no deficiency in the Petitioner's excess profits tax for the year 1944. If it is not, the deficiency is correctly computed (4 Stip. R. 26, 27. Opinion R. 19). The material facts are stipulated (R. 25-40) and recited in the findings promulgated by the Tax Court (R. 13-19).

They are in substance:

(1) Petitioner is and was during all the years 1944 and 1945 an Oregon corporation; during the years 1944 and 1945 it owned and operated a plywood plant at Tacoma, Washington, and was qualified to transact business as a foreign corporation in the State of Washington. It filed its Federal income and excess profits tax returns with and paid its taxes to the Collector of Internal Revenue at Tacoma (1 Stip. R. 25).

(2) On August 30, 1943, Petitioner entered into a contract with T. A. Peterman and wife to purchase approximately 3500 acres of timberland in Tillamook County, Oregon, for which Petitioner agreed to pay $500,000.00; $25,000.00 to be paid on execution of the purchase contract; $75,000.00 on or before September 30, 1943, and the balance—$400,000.00, to be evidenced by a note of the Petitioner payable to the order of Peterman Manufacturing Company. The note to be signed and delivered on or before September 30, 1943. $25,000.00 was paid to apply on the purchase contract when the contract was signed, $75,000.00 paid, and the note

for $400,000.00 signed by Petitioner and delivered on September 30, 1943.

5 and 10 Stip. (R 27, 29), Exhibit 1 (R. 30) and Exhibit 2 (R. 39). Findings (R 14, 15).

(3) A cruise was made of the timber on the land purchased in December 1940 and January 1941. The cruiser estimated 109,528,000 feet of merchantable timber on the tract. Petitioner cut and removed from the tract approximately 90,933,000 feet prior to August 31, 1952. Prior to the purchase a large proportion of the timber had been killed by fire and the time for removal and use of same was limited. The timber was required for use in Petitioner's plant at Tacoma, Washington.

8 Stip. (R 28). Findings (R. 14).

(4) The purchase contract (Exhibit 1) provides among other things:

> That time is the essence of each and every portion thereof. That if the purchaser makes default in payment of any sums owing by it, and the default continues 10 days after written notice thereof, or makes default in the performance of any other term, condition or provision of the contract, and such default continues for 30 days after written notice thereof, the owners (the Vendors) may declare all sums unpaid on the contract, together with interest owing, immediately due and payable, and shall be entitled to bring suit therefor without further notice or demand. It gives the vendors the alternative right to declare a forfeiture in the event of a breach of covenant on the part of the purchaser. (Paragraph 4 of contract).
>
> That no loss or destruction of, nor injury or damage to, any part or all of the property covered hereby shall give ground for the termination or re-

cission of the contract, or relieve the purchaser (Petitioner) in whole or in part from any of the obligations imposed on or assumed by it. (Paragraph 2 of contract).

The contract reserves legal title to the timberland in the Vendors until complete performance by the Vendee (the Petitioner) but makes provisions for title to pass to the logs when cut and severed from the land. (Paragraph 5 of contract).

The Vendors are not required to give deed to the property until the purchaser (the Petitioner) has completed performance of all obligations assumed by it in the contract.

That when the land has been paid for, the Vendors will furnish abstract or title insurance showing good marketable title in the Vendors and will pay revenue or tax stamps for deed. (Paragraph 6 of contract). (R. 30-36).

(5) On October 18, 1943, T. A. Peterman, as a part of the purchase transaction, addressed a letter to Petitioner in which he stated that he and his wife owned all the land described in the contract, with the timber thereon, subject to some minor exceptions such as mineral rights, etc.; that the property was free from encumbrances, except taxes and fire patrol assessments for the years 1943-1944 (which had been assumed by the Petitioner), and that they, the Vendors, would not create any liens thereon and that the Petitioner might enter upon the land, cut and remove the timber so long as it made the payments and observed and performed the conditions of the sale contract.

5 Stip. (R. 27).

(6) T. A. Peterman acquired title to the land in 1941, and had not conveyed or encumbered the same

prior to the execution of the purchase contract (Exhibit 1).

5 Stip. (R. 28). Findings (R. 14).

(7) On September 18, 1943, Petitioner entered into a contract with Peterman Manufacturing Company by which it was agreed that Peterman Manufacturing Company should cut and remove the merchantable timber on the tract for the Petitioner, for which the Petitioner would pay them the market or ceiling price for the timber removed, less certain stipulated stumpage charges; that the Petermans should commence shipping logs from the tract to Petitioner in October, 1943; be in full production by February 1944, and should cut and remove from the tract from twenty to twenty-five million feet per year.

6 Stip. (R. 28). Findings (R. 17).

(8) The Peterman Manufacturing Company was a co-partnership firm, consisting of T. A. Peterman, Katherine Peterman and Gladys Peterman. T. A. Peterman was the managing partner.

6 Stip. (R. 28). Findings (R. 14).

(9) Petitioner's promissory note given for the balance of the purchase price of said property (Exhibit 2) reads:

> "As provided in an agreement dated August 30, 1943, the undersigned, for value received, promises to pay to the order of the Peterman Manufacturing Company the sum of Four Hundred Thousand Dollars ($400,000.00) in lawful money of the United States of America. Payments on this note plus ac-

crued interest at the rate of 3% per annum on deferred balances shall be made on the 15th day of each month beginning November 14, 1943.

"The basis of such principal payments to be $5.00 per thousand feet commercial log scale for all logs except wood logs cut and removed by purchaser or its agents during the previous calendar month as provided in the agreement between T. A. Peterman and Ida C. Peterman, owners, and Oregon-Washington Plywood Company, purchaser, dated August 30, 1943, covering certain timberlands in Tillamook County, Oregon."

(Signed by Petitioner)

Exhibit 2 (R. 39). Findings (R. 16).

(10) On April 15, 1944, in consideration of certain changes in the logging operations, interest accruing on said note after January 1, 1944, was waived for an indefinite period.

11 Stip. (R. 30). Findings (R. 18).

(1) T. A. Peterman died in November 1944; the representatives of his estate wanted to be relieved of the logging contract (Exhibit 4). On January 4, 1946 it was agreed between Petitioner and the representatives of the T. A. Peterman estate, and the surviving co-partners of Peterman Manufacturing Co., that the Petitioner should pay on said note and purchase contract a minimum of $5000.00 per month, commencing June 1, 1946, and the aforesaid logging contract (Exhibit 4) should be cancelled. Also the interest on said note should be waived. Said agreement recites that there was a balance owing on said note and purchase contract on January 4, 1946, of approximately $241,000.00. Thereafter other arrange-

ments were made for the cutting and removal of the timber from said land.

9 Stip. (R. 29). Findings (R. 18).

(12) At a meeting of Petitioner's Board of Directors, held November 4, 1943, its President reported the purchase of said timberland and submitted a copy of the purchase contract (Exhibit 1) and of the note (Exhibit 2) with the statement that the note and the advanced money payments under the contract (to-wit: $100,000.00) completed the payment for the timber and timberland. The transaction was approved by the unanimous vote of the directors.

(Exhibit 9 (R. 41)).

(13) The note, Exhibit 2, has been paid in full with the exception of the portion of the interest waived, and the timberland purchased (described in Exhibit 1) was conveyed to petitioner by warranty deed dated December 22, 1949 (30 R. Findings R. 19).

Petitioner claims the debt was incurred for a business purpose and is evidenced by a mortgage and note within the meaning of Sec. 719 of the Revenue Code. That the purchase contract (Ex. 1, R. 30-36) is in effect a mortgage under Oregon laws. That both the mortgage and the note evidence an unconditional obligation of the petitioner to pay $400,000.00. That there is no deficiency in Petitioner's excess profits tax for the year 1944.

ERROR OF THE TAX COURT RELIED UPON

I.

The Tax Court misinterpreted the legal effect of the purchase contract (Ex. 1, R. 30) and the note (Ex. 2, R. 39) and the other facts stipulated (R. 25-30) and found and promulgated by the Tax Court (R. 13-19).

II.

The Tax Court erred:

(a) In concluding and adjudging that said contract and note, considered alone or in connection with the other facts found by the Tax Court, did not constitute and evidence an unconditional obligation of the Petitioner to pay Peterman Manufacturing Co. the full sum of $400,000.00, and in concluding and adjudging the said indebtedness was not "borrowed invested capital" of the Petitioner within the meaning of Section 719(a)(1) of the Internal Revenue Code, in effect during calendar year 1944.

(b) In concluding and adjudging that Petitioner in computing its excess profits tax for the calendar year 1944, did not have the legal right to take credit for 50 per cent of the average amount owing on said indebtedness during that year, and its unused credits of 50 per cent of the average amount owing on said indebtedness during the calendar year 1945, as "borrowed invested capital", and by determining and adjudging a deficiency

in Petitioner's excess profits tax for the calendar year 1944, in the amount of $19,925.35, or for any amount.

(c) In not determining and adjuging the aforesaid purchase and sales contract was, under the laws of the State of Oregon, in effect a real estate mortgage to secure the payment of the indebtedness owing thereunder, to-wit: $400,000.00, and in not concluding and adjudging that said contract or mortgage and note, considered alone or in connection with other facts connected with the transaction which the Tax Court found to exist, created and evidenced an unconditional obligation of the Petitioner to pay the full sum of $400,000.00, and by not determining and adjudging that Petitioner was within its legal right in taking credit for 50 per cent of the average amount it owed on said indebtedness during the calendar years 1944 and 1945 in computing its excess profits tax for the calendar year 1944.

(d) By not determining and adjudging that there was no deficiency in Petitioner's excess profits tax for the calendar year 1944, and in not vacating the deficiency determined by the Commissioner of Internal Revenue.

III.

More specifically, the Tax Court erred in concluding that the purchase contract (Exhibit 1, R. 30) was a "conditional" land contract and that the balance of the purchase price ($400,000.00) was to be paid during an "indefinite" period; that the monthly payments were "conditional" and that the obligation of Petitioner to pay the balance of the purchase price was "not uncondi-

tional." And by concluding that the clause in the contract giving the vendors the option, in case the Petitioner did not make the payments required of it or defaulted in the performance of the terms of the contract, of either declaring a forefeiture and recovering possession of the timberland, or declaring the whole amount of the debt owing due and sue to collect, made Petitioner's obligation to pay "conditional" (R. 22).

IV.

By concluding that the note (Exhibit 2, R. 39. Findings, R. 17) was "no unconditional promise to pay a certain sum of money on demand, or at a future determinable time."

STATUTES AND REGULATIONS INVOLVED

Section 719, Internal Revenue Code provides:

> "(a) The borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:
>
> "(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust, plus, * * *
>
> "(b) The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 50 per centum of the borrowed capital for such day."

Regulation 112, Sec. 35.719-1 defines borrowed capital substantially as defined in Section 719 R.C., except

it adds the word "promissory" immediately ahead of the word "note".

In the present excess profits tax statute (Sec. 439 Revenue Code, U.S.C.A. Vol. 26, 1952 sup.), Congress included "bank loan agreements" and "conditional sale contracts" as evidence of "borrowed capital."

ARGUMENT

SUMMARY: Congress in enacting 719 R.C., did not attempt to define notes, mortgages or trust deeds, for the obvious reasons (1) it does not have the constitutional power to define such instruments, and (2) the forms differ in many of the states. The true test is:

> Could Exhibit 1 (the purchase contract, R. 30) have been foreclosed under the laws of Oregon, the property therein described sold and the proceds of the sale applied on the debt; or, could judgment have been recovered against Petitioner on the note if it had not been paid within a reasonable time?

The indebtedness for which petitioner took credit in computing its excess profits tax was incurred for a business purpose; was evidenced by both a mortgage and note within the meaning of Section 719, R. C., and petitioner's obligation to pay both was absolute and unconditional.

The property for which the indebtedness was incurred is situated in Oregon. Petitioner is an Oregon corporation. If suit or court action had been necessary to foreclose the mortgage or contract, or to collect on the note, the proceedings would have been in the Oregon

Courts. The instruments should be construed according to Oregon laws.

Under Oregon laws the purchase contract (Ex. 1) is in effect a mortgage. The note (Ex. 2) was an unconditional obligation of petitioner to pay $400,000.00 within a reasonable time.

The note was an independent obligation. The payees could have waived the security and recovered judgment on the note alone.

Petitioner's obligation under both the purchase contract and the note was unilateral.

The optional right of the vendors to declare a forefeiture or sue on the note in the event of petitioner's failure to pay, did not make petitioner's obligation conditional.

EXTENDED: The purpose of Congress in prescribing the character of evidence required to prove an indebtedness for "borrowed invested capital" was to make certain that an unconditional debt exists and that there is legal evidence to prove it or secure payment. The debt is the substance. A note, mortgage and deeds of trusts are three of the muniments which Congress has prescribed as sufficient evidence of borrowed capital. Congress has not the power to prescribe the form of notes, mortgages and trust deeds for use in the various states (*Erie R. Co. v. Tompkins,* 82 L. Ed. at p. 1194, 304 U.S. at p. 78). It evidently intended that any instrument which creates a lien against the property of a taxpayer as security for a debt incurred for borrowed capital, under which the property can be sold and the proceeds

applied on the debt, is a mortgage within the meaning of the statute, and that any form of a promissory note on which judgment may be recovered against the maker under the laws of the State of the maker's domicile is a note, within the meaning of the statute. Congress is not so arbitrary or capricious as to enact that a note or mortgage recognizable as such by the laws of the state of the taxpayer's domicile or where his property is situated, cannot be recognized as such under Section 719 of the Revenue Code because not in the form in use in some of the other states of the union.

When Exhibit 1, the purchase contract, was executed and the petitioner had paid $100,000.00 to apply on the purchase price, and had given its note, Exhibit 2, for the balance, $400,000.00, petitioner became the equitable owner of 3500 acres of timberland with the complete right of possession, and the right to cut and remove the timber therefrom to the same extent as if it had acquired legal title by deed and given a mortgage in common form to secure the balance of the purchase price. This ownership was a valuable property interest. Vendors retained the legal title only as a lien on or claim against petitioner's estate or interest in the property as security for the debt. If the debt had not been paid vendors would have had an unqualified right to foreclose the contract as a common form mortgage and require the property sold and the proceeds of the sale applied on the debt. Had the property sold for more than the debt, the surplus would have been payable to the petitioner. This was not something as good as a mortgage, but a mortgage in reality as recognized by Oregon laws. The fact that vendors might

have had the optional right to a "strict foreclosure" or some other remedy, did not weaken or qualify the right to treat and enforce the instrument as a common form mortgage. The statute (719 R. C.) does not require the mortgage foreclosed or evidence that it will be foreclosed, nor does it require the mortgage to be the only remedy. If the creditor holds an instrument which he can, at his option, foreclose as a mortgage, that is all that is required.

(See authorities, Appendix 1, pages 23-29 this brief).

THE PROMISSORY NOTE

Petitioner does not have to rely upon the issue of whether the purchase contract (Ex. 1, R. 30) is a mortgage. The promissory note (Ex. 2, R. 39) meets all the requirements of Sec. 719(a)(1) of the Revenue Code in effect in 1944 applicable to notes. The note was given and accepted for the balance owing on approximately 3500 acres of timberland having thereon in excess of 100 million feet of merchantable timber. The full agreed price stipulated in the contract was $500,000.00. The contract after mentioning cash payments aggregating $100,000.00 stated the balance owing as $400,000.00 and it should be evidenced by petitioner's note. The note was given and accepted and in the note petitioner unconditionally promised to pay to order of Peterman Manufacturing Company $400,000.00. It is significant that the contract recites the balance owing for the timberland to be $400,000.00 and in the note petitioner unconditionally promised to pay $400,000.00. Neither the contract nor the note stated that petitioner should pay

for timber removed at the rate of $5.00 per thousand feet. Had it been the intention of the parties that the petitioner should only pay for the timber removed, the vendors probably would not have sold the land. Certainly petitioner would not have inconditionally promised to pay the full amount of $400,000.00. Its obligation to pay that amount was not conditional on the quantity of timber removed from the land or on any contingency. The contract expressly provides "that no loss or destruction of * * * or damage to any part or all of the property * * * shall give ground for termination or recission of the contract or relieve purchaser from any of the obligations assumed by it" (R. 33). The note required the accrued interest and something on the principal paid on the 15th of each month. The clause reading.

> "The basis of such principal payments to be $5.00 per thousand feet * * * for logs cut and removed by purchaser or its agents during the previous calendar month"

does not detract from or qualify petitioner's antecedent promise in the body of the note to pay $400,000.00. The term "principal payments," refers to and provides a means of determining the amount of the payments to be made on the principal, monthly. The clause also served to protect the vendors security by requiring payments to be made as timber was removed. There was in excess of 100 million feet of timber on the land, petitioner had the right to cut and remove same; had it not cut and removed enough at $5.00 per thousand feet to pay the note in a reasonable time, the unpaid balance would, by the terms of the note and operation of law, become due and payable. There was an implied promise or obligation

of the petitioner to cut and remove enough timber from the land to pay the note in full within a reasonable time. It was within petitioner's power to do so.

(See authorities cited appendix 2, pp. 30-34 this brief).

The note required interest paid on deferred balances. It is not reasonable that petitioner would undertake to pay interest indefinitely.

The general rule is that where a note is given for a valuable consideration and does not provide the time of payment, it is payable on demand (8 Am. Jur., p. 26, paragraph 278). It logically follows that when all the timber had been removed or destroyed, any balance owing would be payable on demand.

THE NOTE, AN INDEPENDENT OBLIGATION TO PAY $400,000.00.

The payees or holder of the note could have, at their election, waived the security reserved by the purchase contract and recoverd the balance owing on the note by an independent action at law. (Authorities appendix 3, pages 34-35, this brief).

OBLIGATION OF PETITIONER UNILATERAL.

Neither the contract nor the note required anything done by vendors or the payees of the note to make petitioner's obligation to pay all complete and unconditional. The vendors were not required to give deed or furnish abstract or title insurance until after full payment. The logging contract with the Petermans (6 Stip. R 28, Findings R. 17) did not make petitioner's obliga-

tion to pay conditional or the purchase contract bilateral. In this the Petermans were independent contractors. Their obligation to cut and remove from the land from 20 to 25 million feet of logs per year had no relation to the purchase contract or note, any more than if they were strangers. In cutting and removing the timber they were acting for and as representatives of petitioner. Had they defaulted, petitioner could have engaged others to do the logging and would have had an independent right of action against the Petermans for damages (*McCracken v. Bay City Land Co.,* 93 Ore. 461, 183 Pac. 9). The contract did, however, place the Petermans in position to mature as much as $125,000 a year on the note, as they had the right to cut and remove a maximum of 25 million feet a year and were required to cut and remove a minimum of 20 million feet a year. This showed a plan of petitioner to make substantial payments on the note each year.

OPTIONAL RIGHT OF VENDORS TO DECLARE A FOREFEITURE OR COLLECT ON THE NOTE

The Tax Court was clearly wrong in holding that the clause in the contract giving to the vendors the optional right in the event of default in payment, or other default of petitioner, to either declare a forefeiture and retain the payments made, or declare the full balance owing due and sue to collect, made petitioner's obligation to pay the full amount of the note conditional (R. 22). The vendors or the payees of the note were given the unrestricted right to declare the full amount owing due and payable in event of petitioner's default. The fact they could have elected some other remedy did not affect

petitioner's obligation to pay until the election was made. The statute (719 R. C.) does not require the note or mortgage to be the exclusive redemy, nor does it impose on the taxpayer the burden of showing that the creditor would enforce the note or mortgage in the event of default. The right of the payee or mortgagee to enforce the note or mortgage is all that is required. Contracts frequently give the parties the choice of two or more remedies in case of a breach. No one remedy is affected prior to election because the party had the option of using the other. Most every important lease provides that on failure of the lessee to pay rent, or other breach on his part, the lessor may either terminate the lease or collect the rent for the full term. We have never known of a lessee being relieved of his obligation to pay the full agreed rental for the term because the lessor had the optional right, which was not used, to terminate the lease instead of demanding the rent for the full term.

DECISIONS RELIED UPON BY THE TAX COURT.

The facts on which the decisions relied upon by the Tax Court (R. 21-23) were decided are different from the facts in this case. In those cases the obligation of the taxpayer to pay was not definite and unconditional and evidenced by an enforcible note or mortgage.

In condensed form, the issue in this case is, whether the debt—$400,000.00, was an unconditional obligation of the petitioner, and evidenced by either a note or

mortgage, within the meaning of Section 719 Revenue Code.

This note (Ex. 2) should not be confused with those providing for payment "if and when" certain events occur. Here the note was given for value—an existing debt of $400,000.00—petitioner unconditionally promised to pay all. For convenience, payments on the principal were to be made in monthly installments and a practicable means was provided for determining the amounts. It was within the power of petitioner to do what was required to determine the amounts. It had purchased 3500 acres of timberland having thereon more than 100 million feet of merchantable timber and had the right to cut and remove the timber. Prior to the signing of the note had entered into a contract requiring from 20 to 25 million feet per year to be cut and removed from the tract. We think any Court would hold that it was petitioner's unconditional obligation to pay the note in full within a reasonable time—not to exceed six years from its date. That the note or contract alone would be sufficient evidence of the debt and the promise to pay. That when the last of the timber was removed if note had not been paid in full, the balance would be due.

Respondent's contention that the debt was not within the meaning of Section 719 of the Code is not only ultra technical but entirely wrong. The record shows the debt paid in full as planned.

Respectfully submitted,

GEORGE J. PERKINS,
Attorney for petitioner.

APPENDIX 1.

MORTGAGES ON PROPERTY IN OREGON AND PURCHASE CONTRACTS

The statutes of Oregon do not define mortgages, except as shown below:

(a) That mortgages may be foreclosed by suit in equity. (Sec. 9-501 O.C.L.A.)

(b) That a mortgage on real property shall not be deemed a conveyance so as to enable the owner of the mortgage to recover possession of the real property without a foreclosure according to law. (Sec 8-211 O.C.L.A.)

(c) That a mortgage shall not be construed as implying a covenant to pay a debt intended to be secured thereby unless the instrument contains an express covenant to pay, or there is a bond, note or some other instrument obligating the mortgagor to pay the debt. In the absence of such a covenant, or other instrument obligating the mortgagor to pay the debt, the remedy is limited to the land mortgaged. (Sec. 68-101 O.C.L.A.)

(d) In the foreclosure of a mortgage given to secure the purchase price of real property, the decree shall not entitle the mortgagee to a deficiency judgment. (Sec. 9-505 O.C.L.A.)

COURT DECISIONS

In *Marx v. LaRocque,* 27 Ore., at page 48, 39 Pac. 401, the Court said:

"* * * The Court looks beyond the terms of the instrument to the real transaction, and when that is shown, will give effect to the contract of the parties; and whatever may be the form of the instru-

ment, if it was executed as security for a debt, it will be treated as a mortgage."

In *Dickson v. Back,* 32 Ore., at page 235, 51 Pac. 727, the Court said:

> "A mortgage under our statute is nothing but a lien which is discharged by the payment of the debt secured thereby."

In *Schleef v. Purdy, et al.,* 107 Ore., at page 77, 214 Pac. 137, the Court, referring to a mortgage on real property, said:

> "It merely created a lien or encumbrance against the property as security for the payment of a debt or the fulfillment of an obligation."

In *Brewster Shirt Corporation v. Commissioner,* 159 Fed. 2d, a tax case under section 719(a)(1) of the Revenue Code, the shirt corporation entered into an agreement with Mills Factors Corporation under which it assigned its accounts receivable to the Mills Factors Corporation and the latter agreed to advance 90 per cent of the face value of the accounts. The shirt corporation guaranteed payment of the accounts and agreed to purchase any not paid. No promissory note or formal mortgage was given. The Court, by Circuit Judge August H. Hand, at page 229, said:

> "It is clear that as soon as the accounts were assigned and advances made thereon, the agreement and assignments involved securities transaction which under the law constituted a mortgage. What legally is a mortgage is a matter of substance and not a mere form, quoting authorities."

UNDER PURCHASE CONTRACTS (SOMETIMES CALLED "BOND FOR A DEED") PURCHASER ACQUIRES EQUITABLE OWNERSHIP.

In *Collins v. Creason,* 55 Ore., at page 529, 106 Pac. 445, the Court said:

> "* * * It follows that when a valid contract for the sale of real property and the execution of a deed therefor, has been consumated, an equitable title to the premises becomes vested in the vendee, who thereafter is treated as the owner of the land, while the money which it to be paid as a consideration therefor is regarded as the property of the vendor, so that, upon the death of the purchaser, his heirs succeed in equity to the rights of their ancestor in the real property, and upon the death of the vendor, his personal representatives succeed to his right to the purchase money remaining unpaid."

In *Grider v. Turnbow,* 162 Ore., at page 641, 94 Pac. 2d 285, the Court said:

> "By the contract of sale the vendee is considered the equitable owner of the land the vendor retains a lien thereon for the purchase price."

In *Flannagan v. Great Central Land Co.,* 45 Ore., at page 342, 77 Pac. 485, the Court said:

> "By the contract of scale an equitable conversion takes place, the vendee being deemed the owner of the land in equity, and the vender to have a lien thereon for the purchase money."

There are other Oregon decisions to the same effect. The above are believed sufficient to show the rule.

VENDOR RETAINS A LIEN UPON (SOMETIMES CALLED A RIGHT AGAINST) THE PROPERTY AS SECURITY FOR THE UNPAID PURCHASE

PRICE. THIS LIEN OR RIGHT MAY BE FORECLOSED AS A COMMON FORM MORTGAGE, AND, IN SOME INSTANCES, BY A "STRICT FORECLOSURE."

In *Davis v. Wilson,* 55 Ore., at page 407, 106 Pac. 795, the Court said:

> "Under an executory contract for the sale of real estate the vendor, in the absence of language in the bond or contract indicating some other intent, is the holder of the legal title as security for the deferred payments." Quoting authorities

In an early case, *Burkhart v. Howard,* 14 Ore. 39-46, the vendor executed a sales contract, denominated a bond for a deed to certain real property, and in addition to the contract, took from the purchaser a note for the balance of the purchase price. The vendor assigned the note, but did not expressly assign the sales contract or convey the property. The Administrator of the assignee brought suit to foreclose the purchase contract, claiming it was in effect a mortgage to secure the unpaid purchase price, and the assignment of the note had the effect of carrying with it the purchase contract and the vendor's interest in the property, the same as if the note had been secured by an ordinary mortgage. The Court, at page 44, said:

> "The appellant's counsel contends that the effect of the bond (the sales contract) transferred the title in equity to the lots from the former (the vendor) to the latter (the vendee); that he (the vendor) held the legal title merely as security for the payment of the note; and that when he transferred the note to the appellant it entitled the latter to the benefit of the security; that the transaction between said

Monteith (the vendor) and Estelle M. Howard (the vendee) was, in effect a mortgage in favor of the former upon the premises in question, to secure the purchase money, and that when the note was transferred, it was as effectual to transfer the security as the assignment of a note secured by a mortgage would be to transfer the mortgage. It occurred to me upon the hearing that said counsel's position was entirely correct in principle, and I am still of that opinion."

In *Security Savings Co. v. Mackenzie,* 33 Ore. 209-215, at page 212, 52 Pac. 1046, the Court said:

"Mr. Pomeroy, speaking of the rights and equities of a vendor and vendee under a contract for the sale of land, says that, until the terms of the contract are complied with 'the legal title remains in the vendor as security; or, as it is otherwise expressed, he has a lien upon the vendee's equitable estate as security for the payment of the purchase money according to the terms of the agreement. Practically this lien consists of the vendor's right to enforce payment of the price by a suit in equity against the vendee's equitable estate in the land, instead of by the means of an ordinary action at law to recover the debt. * * *

* * * Under this doctrine, the vendee is regarded as the beneficial owner, and the vendor as holder of the legal title as security for the porformanse of the vendee's obligations; and the so called 'lien' is simply the vendor's right to enforce his claim for the purchase money against or out of the vendee's equitable estate, by means of a suit in equity. * * * In the light of this doctrine, the vendor under such a contract has a right, if he choses, to go into a court of equity upon the default of the vendee, and foreclose the latter's equitable interest in the land: *and in such suit the court may either decree a strict foreclosure or a sale of the land, as the equities of the case may suggest.*" (Emphasis added)

In *Flanagan v. Great Central Land Co.,* 45 Ore. 335-346, supra, the Court discussed the rights of the vendor to a strict foreclosure under certain conditions and said:

> "* * * it does not follow that the Court will always declare a strict foreclosure of the contract. It may also decree a foreclosure by a sale of the land in the ordinary way, although the title has not passed from the vendor, dependent upon the exigencies and equities of the case * * * Mr. Story says: 'the usual course of enforcing a lien in equity, if not discharged, is by sale of the property to which it is attached.' "

After quoting other authorities, the Court continued:

> "Thus we find that strict foreclusure is the exception, not the rule, but if required by the equities of the case, the Courts will not hesitate to enforce it."

The Court also discussed the time which should be allowed the vendee to redeem, or pay the balance owing under the contract and retain the property. That depends upon the amount paid on the purchase price, whether the property has increased in value and other conditions. Entirely within the discretion of the Court. In that case, the Court allowed six months from the time the final decree was entered.

In *Grider v. Turnbow,* 162 Ore., at page 641, 94 Pac. 2d 285, the Court followed the two decisions last quoted from, and said:

> "Equity may either grant strict foreclosure of the contract or it may decree a foreclosure by sale of the land in ordinary way. * * *"

In re Estate of Denning, 112 Ore. 621-631, 229 Pac.

912, an executory contract for the sale of land, was treated as a mortgage and forclosed as such.

COMMENT: In some of the decisions the Court refers to the vendor's interest as a lien upon the property sold to secure the balance of the purchase price, and in some as a right to enforce his claim against the vendee's equitable ownership to secure or obtain the balance owing on the purchase price. In all of the cases the Courts recognize that upon the execution of the sales contract and making the initial payment, the purchaser becomes the equitable owner of the land, and the vendor retains the legal title as a lien, or right, to secure the balance of the purchase price, which may be treated and foreclosed as a common form of mortgage. But, if the vendor requests, and in the opinion of the Court the equities justify, the vendor may have the alternative of a "strict foreclosure". That is, the Court may in its discretion require the vendee within a fixed time to pay the full balance owing on the purchase contract or have his estate in the property terminated. In foreolcsure of the common form mortgages the property is advertised and sold to the highest bidder. The mortgagor has one year from date of confirmation of the sale in which to redeem.

APPENDIX 2.

THE PROMISSORY NOTE IS AN UNCONDITIONAL PROMISE TO PAY $400,000.00.

General authorities:

8 Am. Jur., page 27, par. 281, the text reads:

"* * * If the debt for which the instrument (a promissory note) is given is an absolute liability and is due, however, and the happening of a future event is fixed upon merely as a convenient time of payment and the future event does not happen as contemplated, the instrument becomes due and payable within a reasonable time. If the fulfillment of the condition or the happening of the specified event is wholly or partially within the control of the maker of the instrument and if the insturment, read read in the light of surrounding circumstances, shows that the debt is an absolute one, it is only reasonable to suppose that the parties intended that a proper effect should be made to cause the event to happen within a reasonable time. Accordingly, a note, payable when certain land for the purchase of which the note is given is sold by the purchaser, is payable at the expiration of a reasonable time for effecting the sale. Likewise, a mortgagor who makes a note secured by the mortgage and payable when a sale is made by the maker is bound to sell within a reasonable time; otherwise, the note becomes due at the end of such period."

10 C.J.S., page 740, par. 245, the text reads:

"Where the debt for which commercial paper is given is due and the happening of a future event is fixed on merely as a convenient time for payment and the future event does not or cannot happen as contemplated, the law implies a promise to pay within a reasonable time."

THE NOTE SHOULD BE CONSTRUED IN ACCORDANCE WITH OREGON COURT DECISIONS.

In *Nolan v. Bull,* 24 Ore. 479-485, 33 Pac. 983, the instrument read:

> "This is to certify that I, the undersigned, do agree to pay the sum of five hundred dollars unto Delia Nolan when the sale of the property known as the Stephens Ranch shall be accomplished; the said place to be sold for not less than two thousand five hundred dollars."
>
> (Signed) Benjamin Bull

The above debt of $500.00 was for the balance owing for the Stephens Ranch purchased by Benjamin Bull at the agreed price of $2,000.00 (24 Ore., page 480). Decision in 1893. The Court after analyzing decisions of the Supreme Courts of California, Maine, Missouri and Mississippi, and *Nunez v. Dautel,* 19 Wall. 562, sustained the judgment for the debt, and said:

> "Where there is a present debt then due, constituting the basis of an agreement which merely postpones the time of its payment to an uncertain future date, when a certain specified transaction shall be accomplished, *the agreement is to pay within a reasonable time whether such trancastion is accomplished or not."* (Emphasis added)

In *Branch v. Lambert,* 103 Ore. at 437, 205 Pac. 995, the Court said:

> "An obligation which is payable when certain land is sold is payable at the expiration of a reasonable time for effecting the sale: Noland v. Bull, 24 Ore. 479; Hood v. Hamilton Plains Exploration Co., 106 Fed. 408; Crooker v. Holmes, 65 Me. 195 (20 Am. Rep. 687); Hughes v. McEwen, 112 Miss. 35

(72 South. 848, L.R.A. 1917B, 1048, and case note p. 1050).

"What is a reasonable time for effecting the sale depends upon the circumstances of the particular case: Hood v. Hamilton Plains Exp. Co., 106 Fed. 408, 411."

In *Harrison v. Beal,* 111 Ore. at page 570, 222 Pac. 728, the Court said:

"At the outset we remember that a promissory note is an agreement in writing by which the maker promises to pay a certain sum of money absolutely and in all events * * * Unless otherwise provided in the instrument as between himself and the payee of the note, the maker assumes to perform all the affirmative acts required for the fulfillment of the contract." (Quoting authorities)

In *Naftzer v. Buser, et al.,* 106 Kan. 115, 186 Pac. 997, decided 1920, the note read:

"Wichita, Kan., October 25, 1917.

"The following note is given to cover balance of payment of 112,000 shares of stock in Wichita Independent Consolidated Companies at fifteen cents per share, and is to be paid as the stock is sold by Buser & Carney.

"On demand we promise to pay L. S. Naftzer, his heirs or assigns, fifteen thousand eight hundred dollars ($15,800.00), without interest, payments to be made from time to time as the stock is sold, the stock being held in escrow in our office pending sale by us. (Signed) Buser & Carney

H. J. Buser"

The Court said:

"The instrument expresses an obligation to pay which is not itself conditional or contingent. The time of payment alone is uncertain, and the law in

such cases supports instead of defeats the obligation, by *implying a reasonable time.* (Emphasis added). With the time of payment thus fixed the instrument is definite and complete, and discloses an absolute liability which could not be defeated by parol evidence of conditional liability. The cases in which written obligations were not permitted whittled down, or overthrown, or converted into something else, by parol evidence of contradictory agreements between the parties, are so numerous that citation in unnecessary."

In *Crooker v. Holmes,* 65 Me. 195, (20 Am. Rep. 687), the promissory note was made payable "when I sell my place where I now live." Held the maker bound to sell within a reasonable time, and failing in that, the note was due.

The following decisions sustain the rule that where one gives a note for an existing debt, or for any valuable consideration, promising unconditionally to pay, and time of payment to be determined by the occurrence of some specified event, the note is payable within a reasonable time if the event does not or cannot occur. Especially where it is within the power of the maker to cause the event to occur:

California,	Willinston v. Perkins, 51 Cal. 554.
Georgia,	Wilcox v. Turner, 51 Ga. App, 523, 181 S.E. 95.
Illinois,	Emma Allen v. Est. Henry P. Allen, 217 Ill. App. 260.
Iowa,	Works v. Hershy, 35 Ia. 341.
Kansas,	Jones v. Eisler, 3 Kan. 128. Benton v. Benton, 78 Kan. 366, 97 Pac. 378.

Kentucky,	Hicks v. Shouse, 17 B. Monroe, 483.
Massachusetts,	Page v. Cook, 164 Mass. 116, 41 N.E. 115.
Maine,	De Wolfe v. French, 51 Me. 420. Crooker v. Holmes, 65 Me. 195, 20 Am. R. 687. Sears v. Wright, 24 Me. 278.
Missouri,	Ubsdell v. Cunningham, 22 Mo. 124.
Mississippi,	Randall v. Johnson, 59 Miss. 317. Hughes v. McEwen, 112 Miss. 351, 73 South. 59.
Nebraska,	Estate John Backas, 122 Neb. 531 (1932), 240 N.W. 596.
U. S.	Nunez v. Dautel, 19 Wal. 560. Smithers v. Junker, 7 L.R.A. 264, 41 Fed. 101.

APPENDIX 3.

THE NOTE AN INDEPENDENT COVENANT TO PAY.

By the terms of the purchase contract petitioner agreed to pay $500,000.00 for the timberland. The sixth clause of the contract provides that when the purchaser (the petitioner) shall have completed performance of the obligations assumed by it and request a deed the owners (the vendors) shall promptly execute and deliver a deed to purchaser conveying to it said lands. The contract further provides that when the land has been paid for the vendors will furnish abstract or title insurance (Ex. 1, R. 30-36). Nothing is required done by the vendors until petitioner performs all of its obligations, which includes full payment of the agreed price.

In the case of *Walker v. Hewett,* 109 Ore. 366-381 (1923), 220 Pac. 147. The contract reads that if the vendee first made the payments and performed the covenants on his part to be performed under the contract, the vendors would convey to the vendee the property in the contract described. A note was given for the balance of the purchase price. Court action was filed to collect the note indedenpent of the contract and without tender of deed. The right to maintain the action was sustained. The Court quoted *Loud v. Pomona Land & Water Co.,* 153 U.S. 564, 38 L. Ed. 822 and many other decisions as sustaining the right.

In *Oregon and Western Colonization Co. v. Strange,* 123 Ore. 377-383 (1927), 260 Pac. 1002. At page 382 (Oregon report) the Court said:

> "The notes given by the defendants constitute independent contracts and plaintiff could sue on one or all of them without tendering a deed: Hawley v. Bingham, 6 Ore. 76. By the terms of the contract the notes must be paid and other covenants in the contract performed by defendants before they or either of them entitled to a deed. Plaintiff had the option of suing on the notes as they came due and were not paid according to the terms of the contract. Defendants have no right to select for the plaintiff the remedy or course of procedure where it has more than one open to it under the law." (Quoting Walker v. Hewett, supra)

Thorp v. Rutherford, 150 Ore. 163 (1935), 43 Pac. 2d 907.

Bank of California v. Bishop, 137 Ore. 34 (1931), 300 Pac. 1023.

Loud v. Pomona Land & Water Co., 153 U.S. 564; 38 L. Ed. 822.

are to the same effect.